

Message Text

CONFIDENTIAL

PAGE 01 STOCKH 01587 01 OF 04 222114Z

ACTION EUR-12

INFO OCT-01 EA-10 ISO-00 CIAE-00 DODE-00 PM-05 H-01

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R 211313Z APR 78

FM AMEMBASSY STOCKHOLM

TO SECSTATE WASHDC 3615

INFO AMEMBASSY ANKARA

AMEMBASSY ATHENS

AMEMBASSY BERN

AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY CANBERRA

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

AMEMBASSY THE HAGUE

AMEMBASSY HELSINKI

AMEMBASSY LISBON

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AMEMBASSY PARIS

AMEMBASSY REYKJAVIK

AMEMBASSY ROME

AMEMBASSY TOKYO

AMEMBASSY VIENNA

AMEMBASSY WELLINGTON

C O N F I D E N T I A L SECTION 1 OF 4 STOCKHOLM 1587

USOECN ALSO FOR EMBASSY

CONFIDENTIAL

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PAGE 02 STOCKH 01587 01 OF 04 222114Z

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E.O. 11652: GDS

TAGS: ECON, EFIN, SW

SUBJECT: SWEDEN REDUCES EMPLOYERS' PAYROLL TAXES AND
LOWERS REDISCOUNT RATE

REF: STOCKHOLM 986

1. SUMMARY. THE GOVERNMENT INTENDS TO ABOLISH THE TWO PERCENT PAYROLL TAX PAID BY EMPLOYERS AS OF JULY 1, AND THE RIKSBANK HAS REDUCED THE OFFICIAL REDISCOUNT RATE ON SHORT TERM PAPER TO SEVEN PERCENT. THESE ACTIONS WILL HAVE A WELCOME EFFECT ON COST PRESSURES. THEY WILL ALSO INCREASE THE SIZE OF THE NATIONAL BUDGET DEFICIT AND WILL HELP OFFSET A 4.5 PERCENT VOLUME DECREASE IN TOTAL DOMESTIC DEMAND EXPECTED IN 1978. THE ACTIONS WILL NOT, HOWEVER, BE SO EXPANSIONARY THAT INFLATIONARY FIRES WILL BE RELIT. TOTAL DEMAND AND CAPACITY UTILIZATION ARE TOO LOW FOR THAT AT THIS TIME. IT ALSO APPEARS THE SWEDES WILL ACHIEVE A SIZABLE REDUCTION IN THEIR CURRENT ACCOUNTS DEFICIT IN 1978; A REDUCTION WHICH SLIGHTLY MORE DEMAND FOR IMPORTS WILL NOT PREVENT. IF DEMAND FOR INDUSTRIAL INVESTMENT IMPROVES, AS THE MEASURES INTEND, AND WE EXPECT, THESE ACTIONS WILL BE GOOD NEWS FOR US EXPORTERS. ALTHOUGH WE WOULD QUIBBLE WITH THE SIZE OF THE TAX DECREASE, AND THE TIMING, WE BELIEVE THIS WAS A USEFUL STEP BOTH FOR THE DOMESTIC ECONOMY AND FOR US INTERESTS. END SUMMARY.

2. THE SWEDISH GOVERNMENT HAS OFFICIALLY ANNOUNCED
CONFIDENTIAL

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PAGE 03 STOCKH 01587 01 OF 04 222114Z

ITS INTENTION TO ELIMINATE THE PAYROLL TAX, NOW TWO PERCENT OF GROSS WAGES AND SALARIES, ON JULY 1. ACCORDING TO PRIME MINISTER FALLDIN AND FINANCE MINISTER BOHMAN, THIS ACTION IS NECESSARY TO OFFSET SLOWER-THAN-NEEDED INCREASES IN DEMAND FOR EXPORTS: AS A STIMULUS FOR DECLINING DOMESTIC DEMAND; AND AS AN ADDITIONAL COST CUTTING MEASURE. BOHMAN SAYS THAT SWEDISH LABOR COSTS ARE STILL TEN PERCENT TOO HIGH, DESPITE 1977 DEVALUATIONS TOTALING OVER 15 PERCENT, AND THAT SWEDEN'S OECD EXPORT MARKETS ARE NOW EXPECTED TO REGISTER REAL GROWTH OF LESS THAN 4 PERCENT, VERSUS THE 4.5 PERCENT FORECAST OF JANUARY.

3. IN AUGUST 1977 THE PAYROLL TAX WAS ORDERED REDUCED (AS OF JANUARY 1, 1978) FROM FOUR TO TWO PERCENT AS PART OF THE "STABILIZATION PACKAGE" WHICH ACCOMPANIED THE KRONOR DEVALUATION. THE GOVERNMENT INDICATED THE FINAL CUT WOULD FOLLOW LATER. THE RECENT PRIVATE SECTOR WAGE SETTLEMENT, WHICH WOULD INCREASE HOURLY WAGES ONLY 1.9 PERCENT IN 1978, PROVIDED FOR NEW NEGOTIATIONS IF THE CONSUMER PRICE INDEX WERE TO RISE MORE THAN 7.25 PERCENT BETWEEN FEBRUARY AND DECEMBER. THE

SPECTRE OF ELECTION-YEAR NEGOTIATIONS ADDED CONSIDERABLY TO THE NEED TO HOLD DOWN COSTS IN 1978, AND STIMULATED ACTION. THE GOVERNMENT HAS ALREADY REQUIRED THAT IT RECEIVE NOTIFICATION OF PRICE INCREASES ONE MONTH IN ADVANCE AND HAS MADE IT CLEAR THAT WAGE DRIFT WOULD BE COUNTED AGAINST ANY REQUEST FOR A PRICE INCREASE. THIS REDUCTION IN LABOR COSTS MAY RESULT IN CUTTING BY ONE-HALF OF ONE PERCENT THE EXPECTED RISE IN 1978'S CONSUMER PRICE INDEX. SIMULTANEOUSLY, SWEDISH PRODUCERS WILL BE MORE COMPETITIVE WITH IMPORTS AND IN WORLD MARKETS. GOVERNMENT REVENUES WILL BE DECREASED BY AROUND THREE BILLION KRONOR, BUT THE TOTAL PUBLIC SECTOR DEFICIT SHOULD RISE BY ONLY AROUND 1.5 BILLION AS THE GDP GROWS MORE
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PAGE 04 STOCKH 01587 01 OF 04 222114Z

RAPIDLY, AND TAX REVENUES FOLLOW SUIT.

CONFIDENTIAL

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PAGE 01 STOCKH 01587 02 OF 04 251715Z
ACTION EUR-12

INFO OCT-01 EA-10 ISO-00 CIAE-00 DODE-00 PM-05 H-01
INR-10 L-03 NSAE-00 NSC-05 PA-01 SP-02 SS-15
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C O N F I D E N T I A L SECTION 2 OF 4 STOCKHOLM 1587

USOECF ALSO FOR EMBASSY
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 STOCKH 01587 02 OF 04 251715Z

USEEC ALSO FOR EMBASSY

C O R R E C T E D C O P Y FOR RE-NUMBERING (CHANGE PARA 7
TO PARA SIX)

4. REACTION TO THE TAX DECREASE WAS PREDICTABLE. BUSINESS AND FINANCIAL CIRCLES SPREAD THEIR ARMS WIDE. GUNNAR NILSSON, HEAD OF THE CONFEDERATION OF TRADE UNIONS (LO), SAID HE AND SWEDEN'S WORKERS HAVE BEEN CHEATED. THE LO TOOK ITS SOCIAL RESPONSIBILITIES SERIOUSLY, AND ACCEPTED LESS THAN TWO PERCENT INCREASE IN WAGES FOR 1978 IN ORDER TO KEEP COSTS DOWN. NOW THE GOVERNMENT IS ACTING TO TRANSFER EVEN MORE PROFITS TO EMPLOYERS. ACCORDING TO NILSSON, THE TAX DECREASE WILL LEAD DIRECTLY TO PRICE INCREASES AND A FURTHER DECREASE IN THE REAL PURCHASING POWER OF WAGE EARNERS. (HOW HE REACHED THIS CONCLUSION WE DO NOT KNOW.) THE WHITE COLLAR WORKERS (TCO) SAID IT WOULD HAVE BEEN BETTER TO REDUCE DIRECT TAXES. THE SOCIAL DEMOCRATS DECRIED THE GOVERNMENT'S ACTION STRIDENTLY. FORMER PRIME MINISTER PALME CLAIMED THE TAX DECREASE WOULD TRANSFER FOUR BILLION KRONOR PER YEAR TO EMPLOYERS. PARTY NEWSPAPERS PUT THE FIGURE AT 8 OR EVEN 12 BILLION KRONOR. SDP FINANCE MINISTER HEIR APPARENT FELDT SAID: "NEVER HAS THE SWEDISH ECONOMIC POLICY BEEN SO STEERED BY IMPULSE AND STOP AND GO ACTION AS SINCE IT CAME INTO THE HANDS OF GOSTA BOHMAN." ALL SDP MEMBERS POINTED OUT THAT IN RECENT YEARS UNIONS HAVE REFRAINED FROM A PORTION OF WAGE INCREASES IN ORDER TO OFFSET EMPLOYER TAX COSTS.

5. THE RIKSBANK ALSO ACTED ON APRIL 19 TO REDUCE THE
CONFIDENTIAL

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PAGE 03 STOCKH 01587 02 OF 04 251715Z

OFFICIAL REDISCOUNT RATE ON SHORT TERM OBLIGATIONS TO SEVEN PERCENT. THIS FOLLOWS A FEBRUARY 17 REVISION FROM 8 TO 7.5 PERCENT. THE RIKSBANK IS TRYING (REMINISCENT OF OPERATION TWIST IN THE FED'S NOT-TOO-DISTANT PAST) TO INCREASE THE GAP BETWEEN LONG AND SHORT-TERM INTEREST RATES. THEY HOPE TO ENCOURAGE PLACEMENT OF LONG-TERM SAVINGS AND TO PROMOTE SHORT-TERM LENDING. BY MEANS OF LESS VISIBLE CONTROLS, THE BANK WILL SIMULTANEOUSLY KEEP THE LID ON CONSUMER LENDING, WHILE ENCOURAGING INDUSTRIAL BORROWING FOR INVESTMENT. GOVERNMENT FINANCING OF THE SKR 34 BILLION BUDGET DEFICIT EXPECTED IN FY 1978/79 WILL ALSO BE CHEAPER. EMBASSY COMMENT: THE RIKSBANK'S DIRECT CONTROL OF BOND PLACEMENTS AND ITS DIRECT INFLUENCE ON INVESTMENT BANKING MEAN IT CAN STILL FORCE LARGE NUMBERS OF DOMESTIC BORROWERS TO GO ABROAD, THUS FINANCING THE CURRENT ACCOUNTS DEFICIT.

6. IT WILL NOT SURPRISE READERS OF REFTEL TO KNOW THAT THE EMBASSY BELIEVES THE TAX AND DISCOUNT RATE REDUCTIONS ARE STEPS IN THE RIGHT DIRECTION AND IN LINE WITH US POLICY GOALS. THEY SHOULD MEAN A STRONGER DEVELOPMENT OF DOMESTIC DEMAND (FORECAST TO FALL BY FOUR TO FIVE PERCENT IN 1978), AND THUS A SMALLER DECLINE IN THE VOLUME OF IMPORTS, WITHOUT THREATENING EITHER MOVEMENT TOWARD A LOWER RATE OF INFLATION OR BETTER EXTERNAL BALANCE. FAVORABLE COST EFFECTS SHOULD MORE THAN OFFSET THE EFFECTS OF INCREASED DEMAND. CAPACITY UTILIZATION REMAINS BETWEEN 80 AND 85 PERCENT, DEPENDING ON ONE'S ESTIMATE OF UNREALIZED POTENTIAL PRODUCTIVITY DURING THE PAST THREE YEARS, AND COULD BE AS LOW AS 75 PERCENT. IN FACT A REDUCTION OF "WAGE-TAX" BURDENS ON EMPLOYERS HAS BEEN URGED BY BUSINESS AND ACADEMIC ECONOMISTS FOR OVER A YEAR. ON THE DEMAND SIDE, THE ARGUMENT GOES, SUFFICIENT UNDEREMPLOYED LABOR AND UNUTILIZED CAPACITY EXIST THAT ENORMOUS GAINS IN
CONFIDENTIAL

CONFIDENTIAL

PAGE 04 STOCKH 01587 02 OF 04 251715Z

PRODUCTIVITY (AS MUCH AS TEN PERCENT) CAN BE REALIZED IF TOTAL PRODUCTION CAN BE STIMULATED. FURTHERMORE, BETWEEN 1973 AND 1977 THE AMOUNT EMPLOYERS WERE REQUIRED BY LAW TO PAY TO FINANCE A VARIETY OF SOCIAL

WELFARE PROGRAMS WENT FROM 23 BILLION TO 56 BILLION KRONOR; FROM 10.6 PERCENT OF GDP TO 16 PERCENT. TOTAL SOCIAL WELFARE "TAXES" (AND HERE WE INCLUDE NEGOTIATED FRINGE BENEFITS, GROUP INSURANCE, ETC.) HAVE DEVELOPED AS FOLLOWS:

CONFIDENTIAL

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PAGE 01 STOCKH 01587 03 OF 04 251825Z
ACTION EUR-12

INFO OCT-01 EA-10 ISO-00 CIAE-00 DODE-00 PM-05 H-01
INR-10 L-03 NSAE-00 NSC-05 PA-01 SP-02 SS-15
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AMEMBASSY REYKJAVIK
AMEMBASSY ROME
AMEMBASSY TOKYO
AMEMBASSY VIENNA
AMEMBASSY WELLINGTON

C O N F I D E N T I A L SECTION 3 OF 4 STOCKHOLM 1587

USOECD ALSO FOR EMBASSY

CONFIDENTIAL

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PAGE 02 STOCKH 01587 03 OF 04 251825Z

USEEC ALSO FOR EMBASSY

C O R R E C T E D C O P Y FOR MIS-NUMBERING PARA
(CHANGE PARA 9 TO READ PARA 7) CHANGE PARA NINE TO READ
PARA EIGHT CHANGE PARA 10 TO READ PARA 9

EMPLOYER TAXES AND FRINGE BENEFITS AS A PERCENT OF
GROSS WAGES:

	1976	1977	1978
BLUE COLLAR WORKERS	32.7	37.1	42.8
WHITE COLLAR WORKERS	38.7	42.8	44.9

THESE BURDENS WIL LBE REDUCED ACCORDINGLY BY THE GOVERN-
MENT MOVE.

7. MEASURING THE OVERALL IMPACT OF THIS ACTION ON THE
ECONOMY IS PROBLEMATIC AS ALWAYS. SWEDEN HAD ALREADY
MANAGED A SIZABLE IMPROVEMENT IN ITS BALANCE OF TRADE
POSITION, AND ACTUALLY ACHIEVED A TRADE SURPLUS OF
1.2 BILLION KRONOR IN THE FIRST QUARTER OF THIS YEAR,
VERSUS A 2.1 BILLION DEFICIT IN THE SAME PERIOD OF
1977. WITH REASONABLE WAGE SETTLEMENTS, AND A 15 PER-
CENT DEVALUATION (OVER 25 PERCENT AGAINST THE DMARK
AND AS MUCH AS 40 PERCENT AGAINST THE YEN), SWEDISH EX-
PORTERS HAD REASON TO BELIEVE THEY COULD MAINTAIN OR
INCREASE THE 14 PERCENT GROWTH RATE SET IN MARCH.
IT SEEMS TO US THAT A CURRENT ACCOUNT
DEFICIT OF NO MORE THAN SKR 10 BILLION IS
ACHIEVABLE IN 1978 EVEN WITH THE MILD STIMULATION TO
IMPORT DEMAND WHICH RECENT ACTIONS WILL BRING.
ALTHOUGH THE YEAR-ON-YEAR RATE OF INCREASE IN THE
CONSUMER PRICE INDEX REACHED 14 PERCENT IN FEBRUARY,
IN MARCH THE INCREASE OVER FEBRUARY WAS ONLY 0.2
CONFIDENTIAL

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PAGE 03 STOCKH 01587 03 OF 04 251825Z

PERCENT. THIS LATTER WAS THE LOWEST MONTHLY INCREASE
REGISTERED SINCE MAY, 1974, AND ENCOURAGED US IN OUR
FORECAST THAT THE RATE OF INFLATION COULD BE AS LOW AS
8 PERCENT BY DECEMBER. AT LEAST FIVE PERCENT OF RE-
CENT RATES OF INFLATION WERE IN ANY EVENT DIRECTLY
ATTRIBUTABLE TO DEVALUATION AND INDIRECT TAX INCREASES.

8. IN OUR MINDS, THE UNANSWERED QUESTION IS: "WHY
NOW AND WHY SO LITTLE?" PUBLIC SECTOR WORKERS ARE NOW

NEGOTIATING THEIR 1978 PAY INCREASES. RUMBLINGS OF DISCONTENT HAVE BEEN HEARD FROM LO MEMBER UNIONS WHO ARE NOW IN THE PROCESS OF NEGOTIATING THE SUPPLEMENTARY CONTRACTS WHICH FOLLOW THE NATION-WIDE AGREEMENT ACCEPTED BY THE LO IN FEBRUARY. THE DANGER OF INCREASED WAGE DRIFT AND/OR LABOR STRIFE HAS CLEARLY BEEN INCREASED BY THE TAX REDUCTION.

9. AT THE SAME TIME, WE NOTE THAT ACADEMIC AND BUSINESS ANALYSTS HAVE ARGUED THAT A DECREASE IN EMPLOYER WAGE "TAXES" OF TEN PERCENTAGE POINTS WAS NECESSARY TO BRING COSTS INTO LINE. SUCH A DECREASE WOULD HAVE FACILITATED A SHIFT IN THE DISTRIBUTION OF NATIONAL INCOME BACK TOWARD PROFITS, A SHIFT WHICH EVEN THE SOCIAL DEMOCRATS ADMIT PRIVATELY IS NECESSARY. IF THE GOVERNMENT WAS READY TO TAKE THE INEVITABLE POLITICAL FLAK, WHY NOT TAKE A MORE SIZABLE TEP IN EXCHANGE FOR VERY LITTLE MORE OPPOSITION? BOHMAN HIMSELF HAS SAID THAT SWEDISH LABOR COSTS ARE STILL TEN PERCENT TOO HIGH. IN FACT, BOHMAN HAD HOPED FOR A TOTAL DECREASE OF FOUR PERCENTAGE POINTS, BUT COULD NOT CONVINCE THE LIBERAL PARTY TO GO ALONG. MOREOVER, THE ARGUMENT THAT STIMULATED ECONOMIC ACTIVITY WOULD MEAN MORE TAX REVENUE DID NOT GET VERY FAR WITH THE LAYMEN WHO HEAD THE GOVERNMENT, AND WHO SHARE WIDESPREAD FEARS ABOUT THE EFFECT OF INCREASING THE ALREADY LARGE NATIONAL BUDGET DEFICIT. FINANCE MIN-
CONFIDENTIAL

CONFIDENTIAL

PAGE 04 STOCKH 01587 03 OF 04 251825Z

ISTRY ECONOMISTS ARE ALSO MOST CONCERNED THAT THEY NOT START IN TRAIN EXPANSIONARY MEASURES WHICH, WHEN THE LAGS ARE WORKED THROUGH, MAY HAVE THEIR FULL EFFECT WHEN RECOVERY IS WELL UNDERWAY, I.Z., STIMULUS NOW MIGHT PROVE PRO-CYCLICAL IN THE END.

CONFIDENTIAL

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CONFIDENTIAL

PAGE 01 STOCKH 01587 04 OF 04 251852Z
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INR-10 L-03 NSAE-00 NSC-05 PA-01 SP-02 SS-15
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C O N F I D E N T I A L SECTION 4 OF 4 STOCKHOLM 1587

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CONFIDENTIAL

CONFIDENTIAL

PAGE 02 STOCKH 01587 04 OF 04 251852Z

USEEC ALSO FOR EMBASSY

C O R R E C T E D C O P Y FOR MIS-NUMBER OF PARA)
(CHANGE PARA 11 TO READ 10 AND PARA 12 TO READ 11)

10. THE RESULT IS SOMETHING REMINISCENT OF THE
APRIL 1 DEVALUATION: AN ACTION MANY BELIEVE IS
NECESSARY, BUT WHICH WOULD HAVE BEEN FAR MORE EFFECTIVE
IF TAKEN IN LARGER MEASURE, AND WHICH WILL DRAW AS
MUCH POLITICAL ANIMOSITY AS IF IT HAD BEEN LARGER IN
THE FIRST PLACE. THE APRIL DEVALUATION OF SIX PERCENT
MERELY LED TO EXPECTATIONS OF FURTHER DEVALUATION.

SIZABLE OUTFLOW OF CAPITAL, POSTPONEMENT OF EXPORTS,

ACCELERATION OF IMPORTS AND OTHER CHANGES IN LEADS AND LAGS MADE THE AUGUST DEVALUATION EVEN MORE UNAVOIDABLE THAN IT OTHERWISE WOULD HAVE BEEN, AND COST THE SWEDISH RISK BANK SIZABLE FOREIGN EXCHANGE LOSSES.

11. DESPITE THESE QUIBBLES, WE REMAIN OPTIMISTIC. AS STATED IN REFTEL, WE BELIEVE ROOM FOR "INFLATION-FREE" EXPANSION EXISTS, AND BELIEVE THIS ACTION IS IN LINE WITH OUR OWN POLICY AIMS. ALTHOUGH THE INCREASE IN IMPORTS WHICH THE ACTION WILL ENTAIL WILL BE MARGINAL IN A WORLDWIDE PERSPECTIVE, THEY WILL STILL BE IN THE RIGHT DIRECTION.
KENNEDY-MINOTT

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